

# US elections: The tribe has spoken

## Economic research note

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- The US election have returned the status quo: Barack Obama remains as President, the Democrats control the Senate and the Republicans control the House.
- First order of business will be to do a deal on the Fiscal Cliff, which currently implies a 4%pts of Gross Domestic Product (GDP) contraction in 2013. This would drive the economy back into recession.
- A short-term compromise deal on the fiscal cliff is likely before the end of the year. A more meaningful ‘grand bargain’ would then be the aim over H1 13. Significant risk and uncertainty remains around this issue.
- The US debt ceiling must be raised from the current \$US16.39trn by Q1 13. The risk of a further credit rating downgrade is high if the political process around the debt ceiling is, once again, highly partisan.
- A re-elected president Obama implies a continuation of the current monetary policy stance of the Federal Reserve. Even if Chairman Bernanke is not re-appointed in January 2014, the new Chair would likely be a current Board member (vice Chair Yellen or NY Fed President Dudley) and would continue with the same policy direction.

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### US elections: The tribe has spoken

The US elections have returned the status quo: Barack Obama remains as President, the Democrats retain their majority in the Senate and the Republicans still control the House.

As shown in the table below, President Obama has won at least 303 Electoral College votes, easily surpassing the 270 minimum required to claim the Presidency. The state of Florida remains ‘undecided’, which could add a further 29 votes for Obama (or Romney).

### US Presidential election outcome

	Electoral Collage	Popular vote
Obama	303	50%
Romney	206	48%
Undecided	29 (Florida)	--

Source: ISI and Bloomberg

### Fiscal cliff:

The first order of business for the President will be dealing with the so-called Fiscal Cliff. This is likely to start on Tuesday next week, after the holiday for Veteran’s Day on Monday.

Left alone, current legislation will see a tightening of fiscal policy of 4%/pts of GDP in 2013, through a combination of tax increases and spending cuts.

While it is imperative that the US deals with its medium-term fiscal issue and brings the budget deficit back under control, a 4%/pts contraction in 2013 will surely drive the economy back into recession – an outcome to be avoided.

The President has reportedly spoken with the key leaders of both the House and Senate. He has informed them that the message from the election was that both parties need to work together to find a sustainable solution to both the fiscal cliff and the need for medium-term fiscal consolidation.

This will be no small feat and markets have reacted to the election in a way that signals ongoing concern over

the ability of the political process to deliver a meaningful and sustainable outcome.

Given the time-frame now ahead of the President, the most likely outcome would seem to be a temporary deal before the end of the year that extends the dead-line of the fiscal cliff out 3-6 months.

This will then allow both parties sufficient time to agree on a meaningful and long-term deal (a ‘grand bargain’) that progressively reduces the budget deficit over a number of years, rather than front-loading the adjustment into 2013.

Consensus seems to be that the fiscal contraction in 2013 will be around 1%-1.5%pts of GDP, rather than the 4% under current legislation.

While this would be considered a ‘good’ outcome it is likely to keep overall GDP growth for the US economy to around 2%-2.5% in 2013, ie. the same as in 2012.

In addition, the President will also need to get agreement from the House and Senate to raise the US debt ceiling. The debt ceiling of \$US16.394 trillion, which was agreed in August 2011, is fast approaching, with the current level of debt outstanding estimated at \$US16.17 trillion.

If a deal is not done to raise the debt ceiling, then a situation like August 2011 could easily arise, where questions are asked about the US ability to repay its debt and keep government operating.

The credit rating agencies have clearly warned that a failure to come to a deal on raising the debt ceiling is likely to lead to further negative credit ratings action.

**Monetary policy:**

The most important implication for monetary policy from the re-election of President Obama is that Ben Bernanke’s chairmanship of the Federal Reserve is safe and that the policy of QE3 (or QE infinity) will continue.

Ben Bernanke’s term as Chairman of the Fed expires in

January 2014. While he may still decide not to seek re-appointment at that time, the transition to a new Chair is likely to be much smoother than it would have been under a Romney Presidency.

Current vice-Chair Janet Yellen is likely to be the favoured candidate to take over as Chair of the Fed in early 2014 and would, if required, continue to policy direction for the Fed that has been firmly set by Bernanke. The current NY Fed President, William Dudley, is also mentioned as a possible candidate as the next Chairman. He too is strongly supportive of the current QE policy.

**The House and Senate**

As noted above, the political positions of both the House and Senate are unchanged, with the Republican in control of the House and the Democrats in control of the Senate (although some seats remain undecided).

As was the case prior to the election, therefore, all legislation, including that on the fiscal cliff and debt ceiling, will need to be negotiated with both parties and a compromise deal reached.

**The US House and Senate**

Party	Previous	Previous	New	New
	Republican	Democratic	Republican	Democratic
House*	240	190	236^	190^
Senate**	47	53	45	55

\* There are 5 vacancies  
 \*\* Two independents caucus with the Democrats  
 ^ 9 seats remain undecided at this stage.  
 Source: ISI

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